# Consumer Discretionary

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# Agenda

- Overview
- Business Analysis
- Economic Analysis
- Financial Analysis
- Valuation Analysis
- Recommendation

# Sector Overview

# Definition

- The Consumer Discretionary sector is made of companies producing products and services that are not necessities:
  - Hotels, Restaurants & Leisure
  - Media
  - Consumer Durable & Apparel
  - Automobiles & Components
  - Retailing
- The degree of spending the amount of consumption depends on individuals.
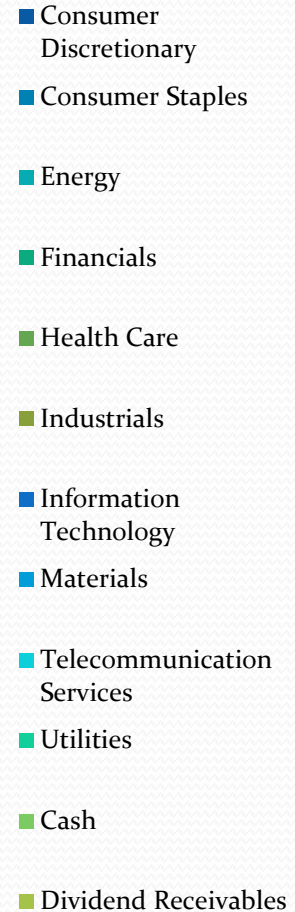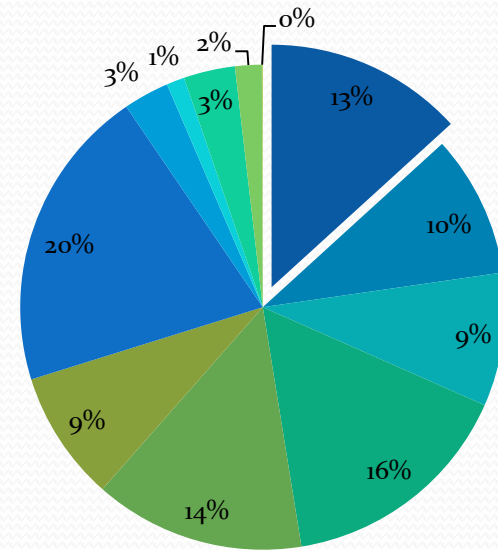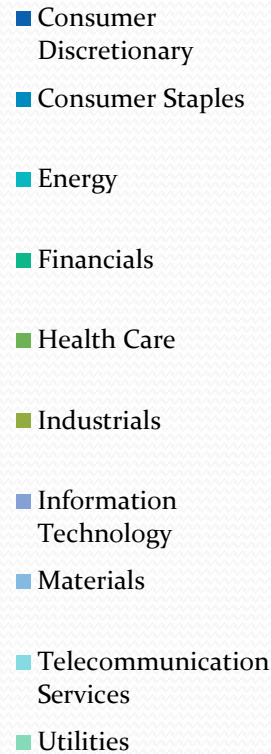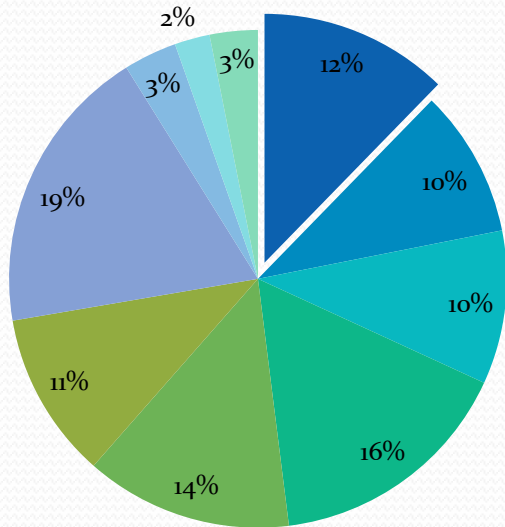- Very cyclical sector, which perform better in boom

# Largest Companies

| Company Name | Exchange: Ticker | Market Cap (mm) |
|---|---|---|
| Amazon.com Inc. | NasdaqGS:AMZN | 164,563.83 |
| The Walt Disney Company | NYSE:DIS | 140,532.65 |
| Comcast Corporation | NasdaqGS:CMCS.A | 131,450.22 |
| The Home Depot, Inc. | NYSE:HD | 114,038.22 |
| McDonald's Corp. | NYSE:MCD | 95,642.30 |
| Twenty-First Century Fox, Inc. | NasdaqGS:FOXA | 74,966.57 |
| priceline.com Incorporated | NasdaqGS:PCLN | 70,573.68 |
| Nike, Inc. | NYSE:NKE | 69,165.22 |
| Ford Motor Co. | NYSE:F | 59,748.91 |
| Time Warner Inc. | NYSE:TWX | 57,978.10 |

# Sector Breakdown

- S&P 500
- 12.29%

- SIM
- 13.24%
- Overweight：0.95%



S&P 500 pie chart legend: Consumer Discretionary, Consumer Staples, Energy, Financials, Health Care, Industrials, Information Technology, Materials, Telecommunication Services, Utilities

Values: 12%, 10%, 10%, 16%, 14%, 11%, 19%, 3%, 2%, 3%



SIM pie chart legend: Consumer Discretionary, Consumer Staples, Energy, Financials, Health Care, Industrials, Information Technology, Materials, Telecommunication Services, Utilities, Cash, Dividend Receivables

Values: 13%, 10%, 9%, 16%, 14%, 9%, 20%, 3%, 1%, 2%, 3%, 0%

# Sector Performance

- YTD: S&P 500 outperformed by 1%
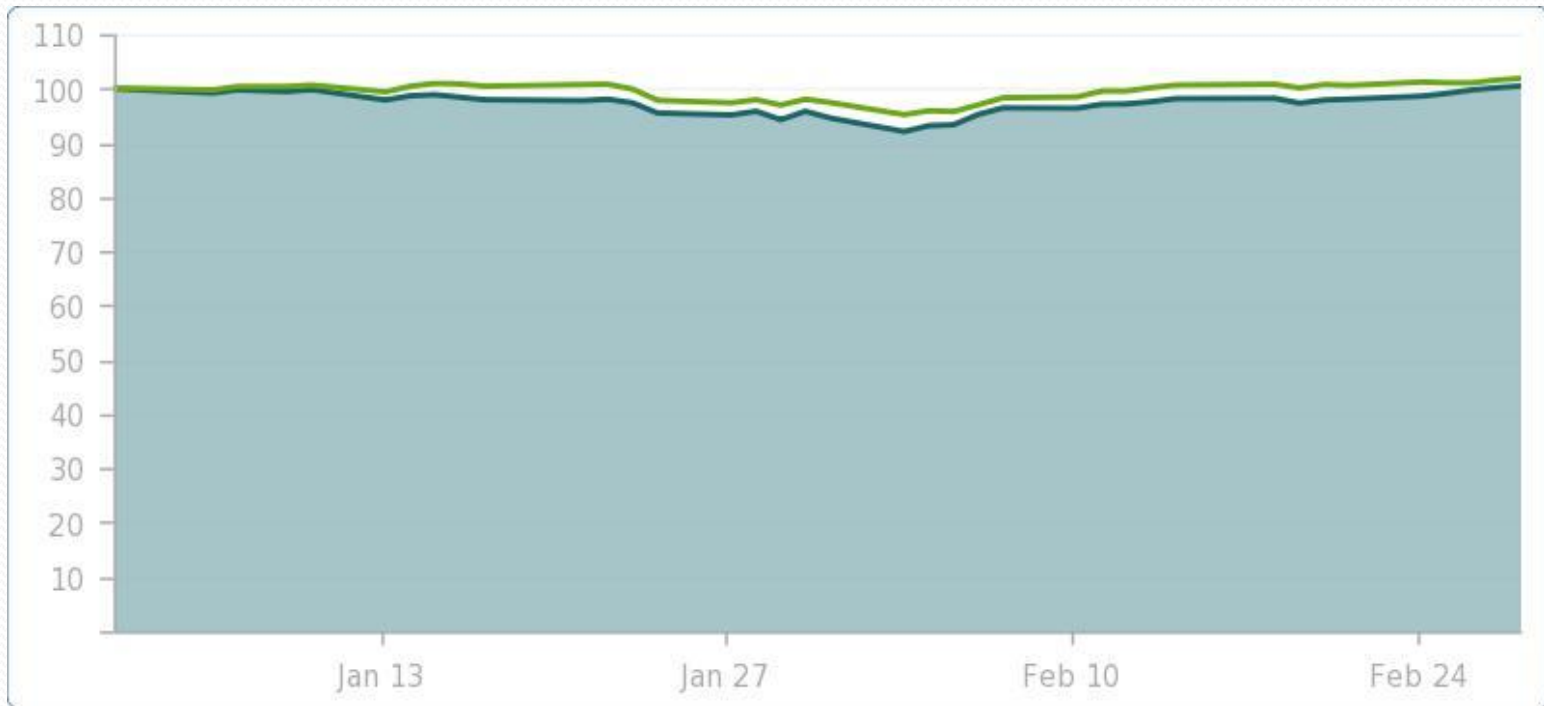


| Index Name | Total Return | YTD Returns | |
|---|---|---|---|
| ■ S&P 500 Consumer Discretionary (Sector) (TR) | 680.88 | -0.04 % ▼ | |
| ■ S&P 500 (TR) | 3,347.38 | 0.96 % ▲ | ⊗ |

# Sector Performance

- 1 Year: Con Dis outperformed by 8.42%



| Index Name | Total Return | 1 Yr Ann. Returns |
|---|---|---|
| ■ S&P 500 Consumer Discretionary (Sector) (TR) | 680.88 | 33.79 % ▲ |
| ■ S&P 500 (TR) | 3,347.38 | 25.37 % ▲ |

# Sector Performance

- 5 Year: Con Dis outperformed by 9.89%



| Index Name | Total Return | 5 Yr Ann. Returns | |
|---|---|---|---|
| ■ S&P 500 Consumer Discretionary (Sector) (TR) | 680.88 | 32.89 % ▲ | |
| ■ S&P 500 (TR) | 3,347.38 | 23.00 % ▲ | ⊗ |

# Sector Performance

| | Annualized Returns | | | Annualized Risk (Std Dev) | | |
|---|---|---|---|---|---|---|
| | 1 Year | 3 Year | 5 Year | 1 Year | 3 Year | 5 Year |
| S&P 500 Con Dis | 33.79 % | 21.35 % | 32.89 % | 13.12 % | 17.68 % | 20.44 % |
| S&P 500 | 25.37 % | 14.35 % | 23.00 % | 11.30 % | 16.67 % | 18.31 % |

| | Index Level | 1 Day | MTD | QTD | YTD |
|---|---|---|---|---|---|
| S&P 500 Con Dis | 680.88 | 0.34 % | 6.24 % | -0.04 % | -0.04 % |
| S&P 500 | 3,347.38 | 0.28 % | 4.57 % | 0.96 % | 0.96 % |

The Correlation between S&P 500 and Con Dis is 0.945.

# Business Analysis

# Sector Performance

- Overperforms: Early
- Underperforms: Late & Recession
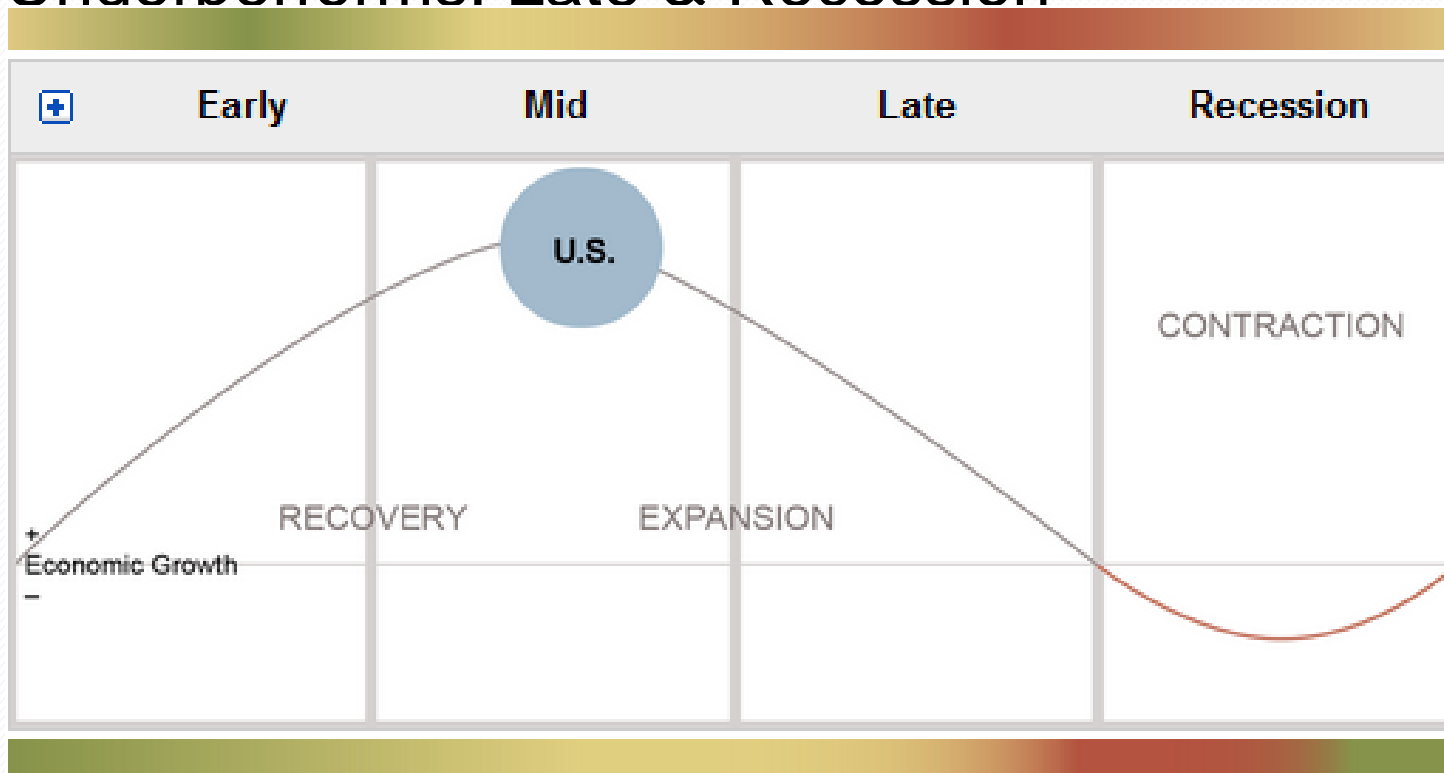
# Life Cycle & Business Cycle

- The phase of this life cycle is mature in which the performance of the sector is very dependent upon the amount of disposable income in the economy.

- When the economy booms this sector booms with it as the consumer is more likely to spend.

- The consumer discretionary sector is currently in the mid-cyclical phase. This phase is typically the longest phase of the business cycle.

- It is characterized by a positive but moderate rate of growth than that experienced during the early-cycle phase.

- Economic activity is inclusive, but not limited to momentum, strong credit growth, and the profitability is very healthy. We see growth in both inventories and sales.

- The performance of this sector is also highly correlated with the economic performance of the United States and foreign countries.

# Influencing Factors

- Outstanding debt
- Unemployment Rates
- Mortgage Market
- Consumer Price Index
- Consumer spending
- Consumer confidence
- Disposable Income
- Consumer default rates
- Financial obligations

# Porter's Five Forces

## Barriers to Entry - Medium/High

- Serious advantages for incumbents, leverage established networks for better deals
- Huge start up costs in some industries, ex. automobile industry
- New entrants can compete on smaller scale and in niche markets

## Buyer Power - Very strong

- All industries must compete with each other and leisure activities.

## Supplier Power - Weak/Medium

- Weak for industries that outsource overseas, ex. Apparel industry
- Medium for industries with a strong union presence, ex. Automobile and Movie/TV
- Manufacturing industries may have to deal with rising material costs

## Substitutes – High

- Many alternatives with like products.
- One industry can be substituted for another

## Competition – Medium/High

- High for retailer, restaurant, and apparel industries.
- Medium competition in industries dominated by fewer firms, ex. Automobile industry
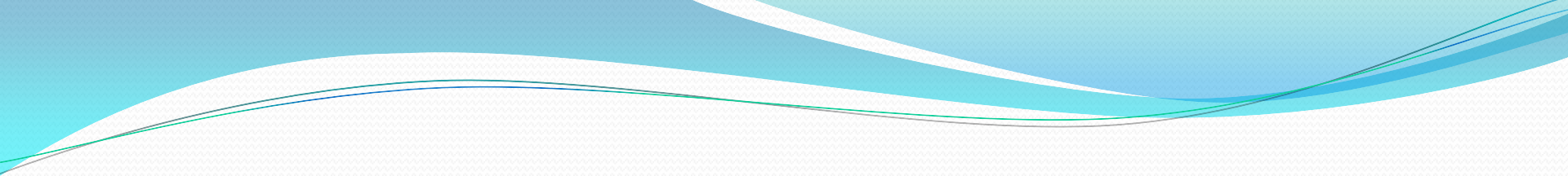
# Economic Analysis

# US Consumer Attitude & Spending

# UM Consumer Confidence Sentiment

# US Disposable Personal Income

# Nominal GDP

# US Employment

# Regression Result

SUMMARY OUTPUT

| Regression Statistics | |
|---|---|
| Multiple R | 0.941953012 |
| R Square | 0.887275476 |
| Adjusted R Square | 0.866780108 |
| Standard Error | 28.64333922 |
| Observations | 40 |

ANOVA

| | df | SS | MS | F | Significance F |
|---|---|---|---|---|---|
| Regression | 6 | 213108.76 | 35518.12666 | 43.29151246 | 2.95055E-14 |
| Residual | 33 | 27074.5491 | 820.4408819 | | |
| Total | 39 | 240183.3091 | | | |

| | Coefficients | Standard Error | t Stat | P-value | Lower 95% | Upper 95% | Lower 95.0% | Upper 95.0% |
|---|---|---|---|---|---|---|---|---|
| Intercept | -1024.964545 | 124.4594833 | -8.235327017 | 1.64646E-09 | -1278.179268 | -771.7498224 | -1278.179268 | -771.7498224 |
| CPI | 0.126034343 | 5.361002318 | 0.023509474 | 0.981385467 | -10.78100688 | 11.03307557 | -10.78100688 | 11.03307557 |
| Unemployment Rate | -1.742408122 | 4.332814007 | -0.402142377 | 0.690172194 | -10.5575845 | 7.072768256 | -10.5575845 | 7.072768256 |
| UM consumer Confidence | 4.7533154 | 0.826000099 | 5.754618441 | 1.98774E-06 | 3.072805563 | 6.433825236 | 3.072805563 | 6.433825236 |
| personal Income | 2.960431974 | 2.648987366 | 1.117571194 | 0.271820639 | -2.428973346 | 8.349837294 | -2.428973346 | 8.349837294 |
| Nomimal GDP | 0.064062608 | 0.004523137 | 14.16331315 | 1.40004E-15 | 0.054860216 | 0.073265 | 0.054860216 | 0.073265 |
| Real GDP | 1.738530904 | 2.643682888 | 0.657617036 | 0.515345472 | -3.640082372 | 7.11714418 | -3.640082372 | 7.11714418 |

# Financial Analysis

# Revenue per share

| 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | Current |
|------|------|------|------|------|------|------|------|------|---------|
| $286.83 | $310.05 | $330.24 | $324.01 | $264.51 | $271.25 | $298.58 | $316.21 | $369.64 | $373.32 |
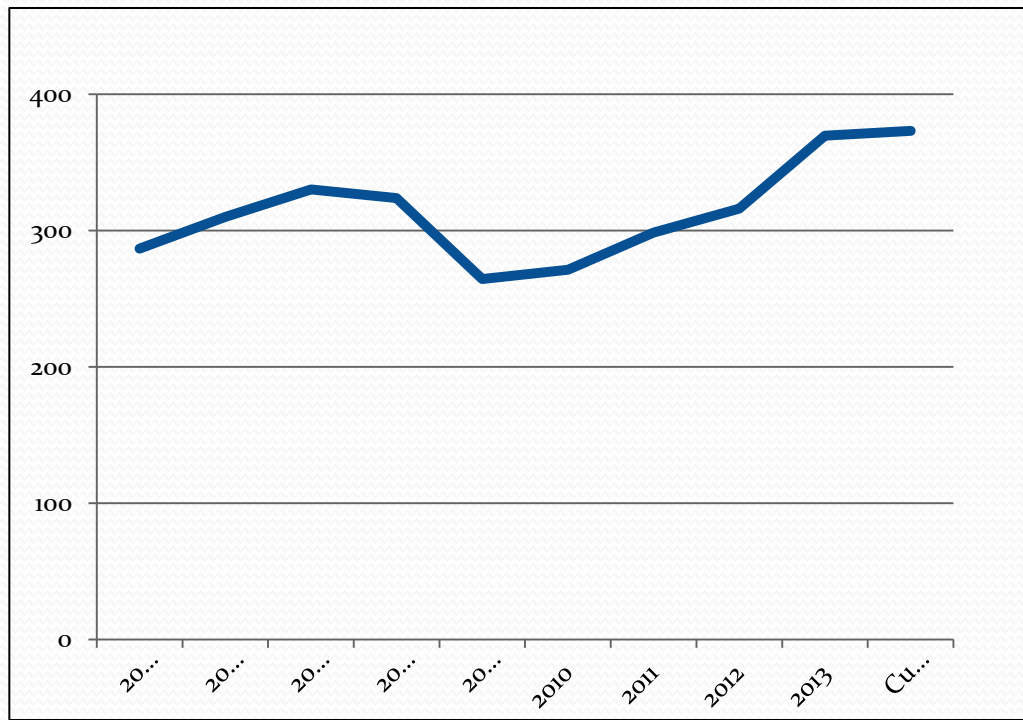
# Net profit margin (absolute)

| 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | Current |
|------|------|------|------|------|------|------|------|------|---------|
| 2.25% | 3.89% | 1.04% | -3.77% | 4.14% | 6.21% | 7.68% | 6.52% | 7.02% | 6.96% |
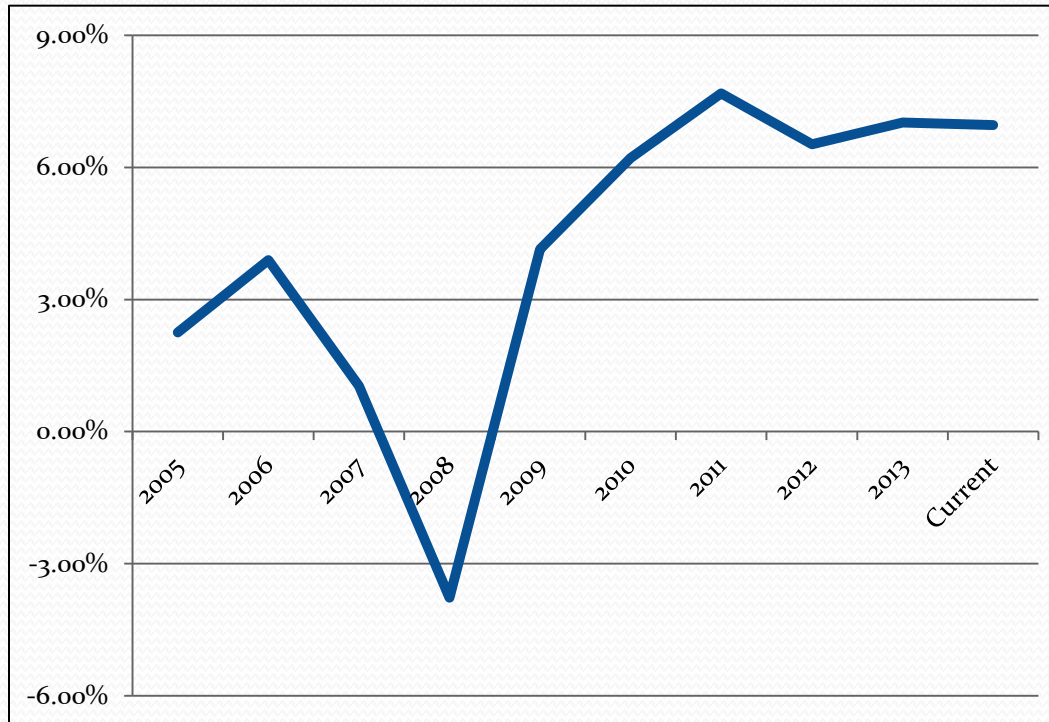
# Net profit margin (relative to S&P)

| 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | Current |
|------|------|------|------|------|------|------|------|------|---------|
| 0.27 | 0.41 | 0.15 | -1.56 | 0.66 | 0.73 | 0.86 | 0.79 | 0.73 | 0.76 |
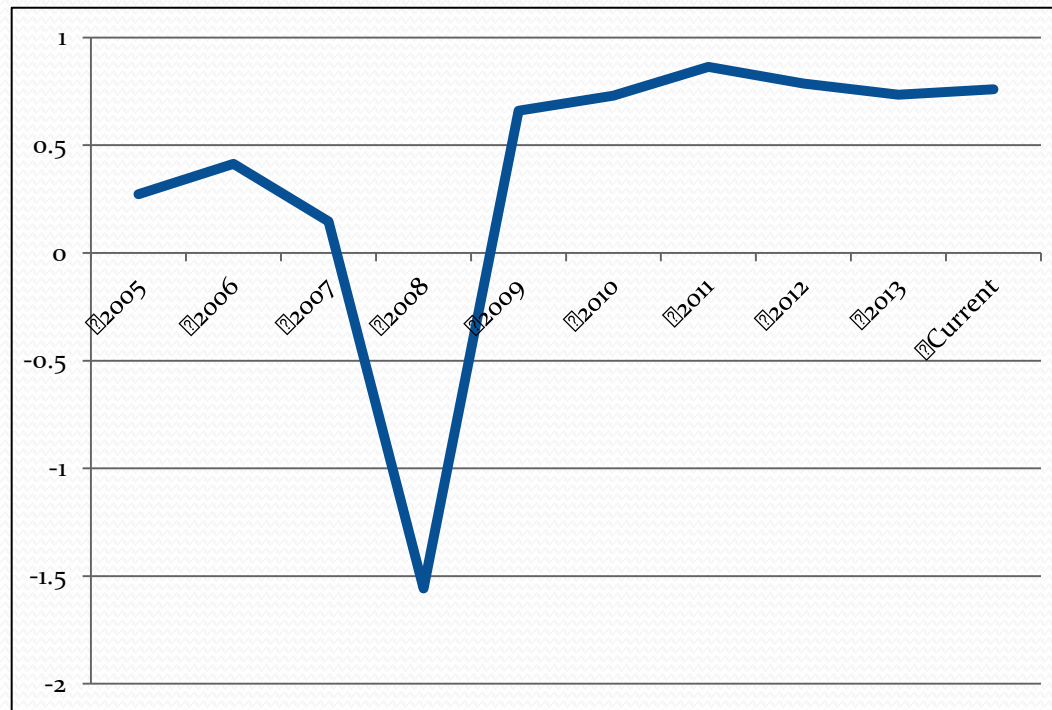
# Earnings per Share (EPS)

| 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | Current |
|------|------|------|------|------|------|------|------|------|---------|
| 11.78 | 14.67 | 14.74 | 4.04 | 12.94 | 17.3 | 23.27 | 21.28 | 25.28 | 25.3 |
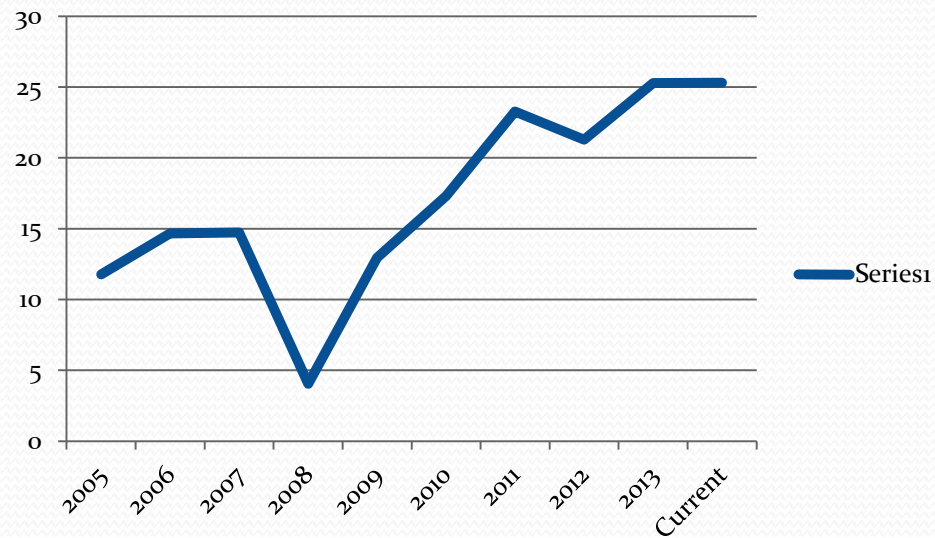
# Return on Equity (ROE)

| 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | Current |
|------|------|------|------|------|------|------|------|------|---------|
| 5.98% | 10.94% | 3.1% | -13.86% | 11.95% | 17.35% | 22.40% | 19.67% | 21.93% | 21.87% |
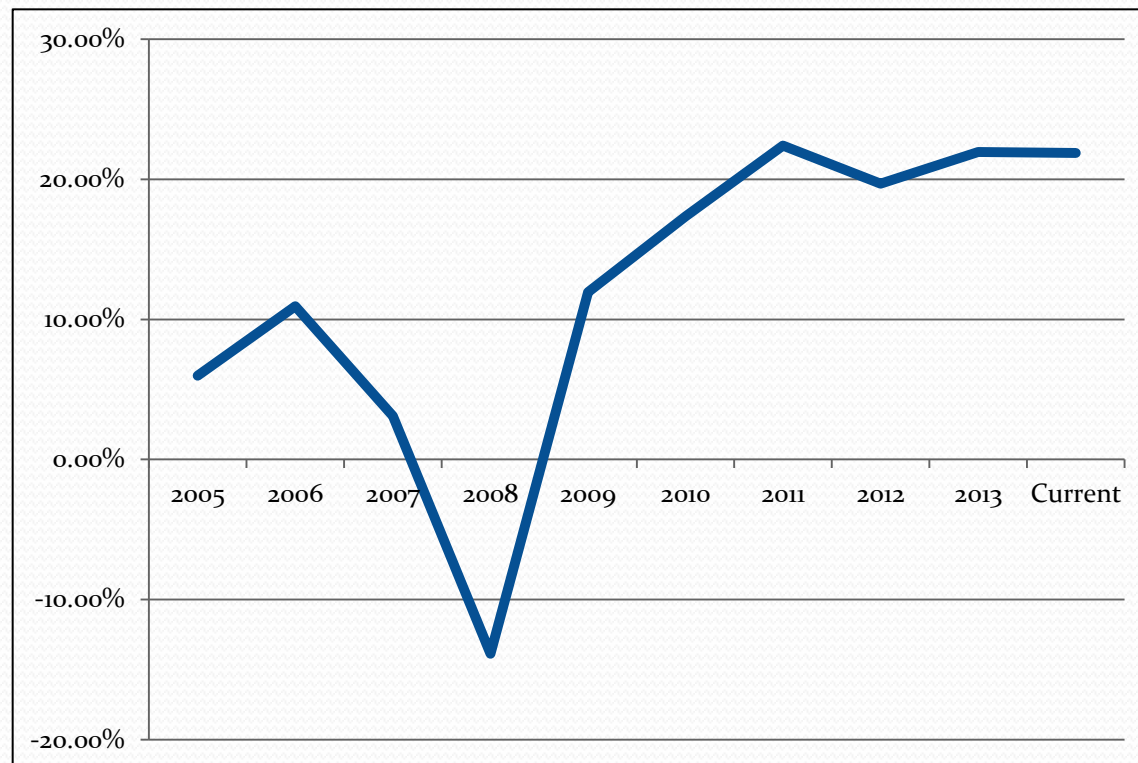
# Industry- Net Profit Margin

| Hotel, restaurants, & leisure | media | Retailing | Automobiles & components | Consumer durable & apparel |
|---|---|---|---|---|
| 10.66% | 6.88% | 4.35% | 0.19% | 5.39% |
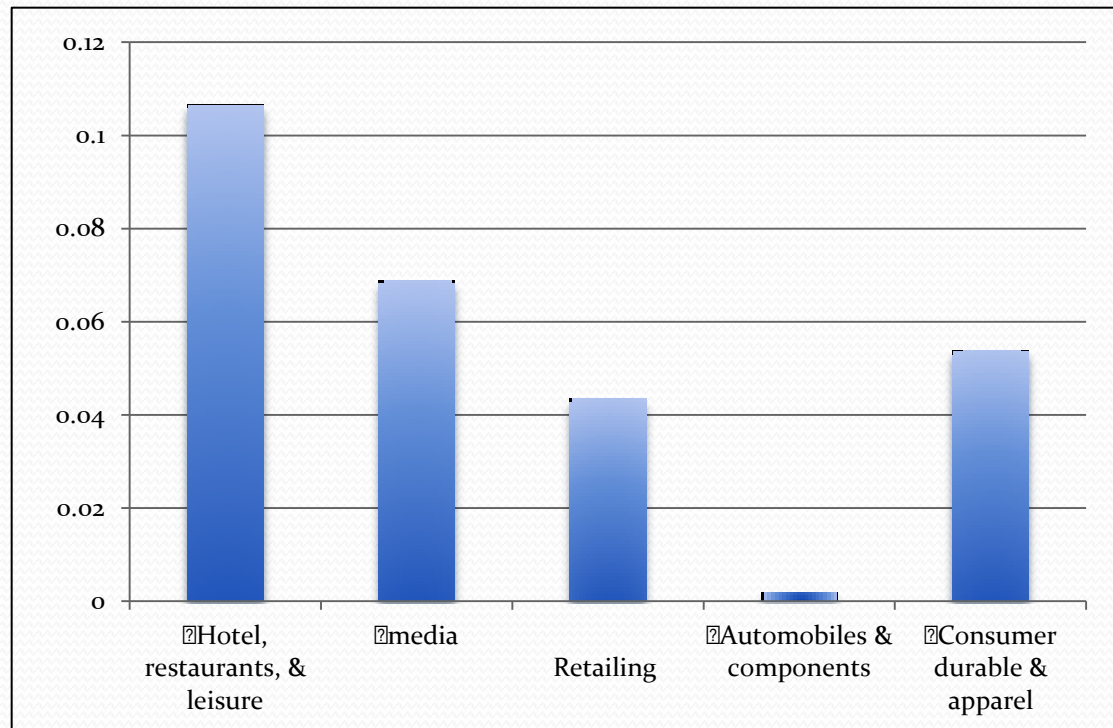
# Industry- ROE

| Hotel, restaurants, & leisure | media | Retailing | Automobiles & components | Consumer durable & apparel |
|---|---|---|---|---|
| 22.25% | 10.03% | 17.96% | -18.60% | 13.00% |
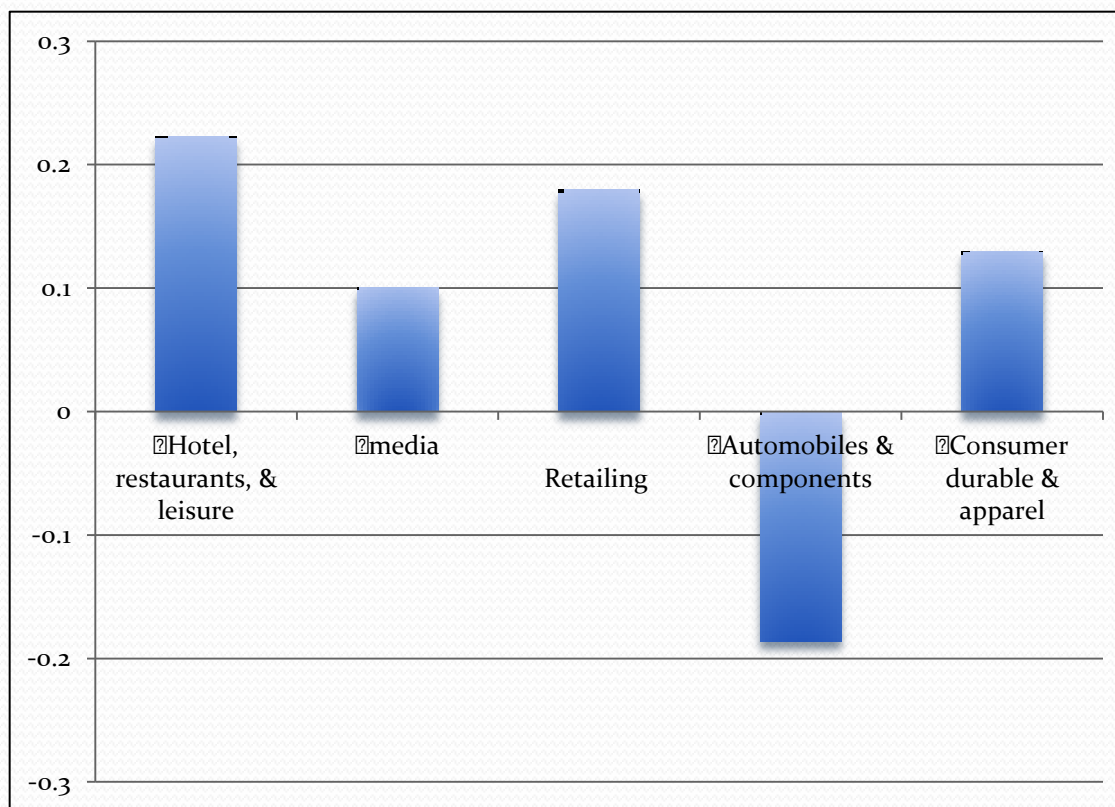
# Industry- Revenue per share

| Hotel, restaurants, & leisure | media | Retailing | Automobiles & components | Consumer durable & apparel |
|---|---|---|---|---|
| $224.00 | $143.44 | $605.13 | $412.36 | $162.73 |
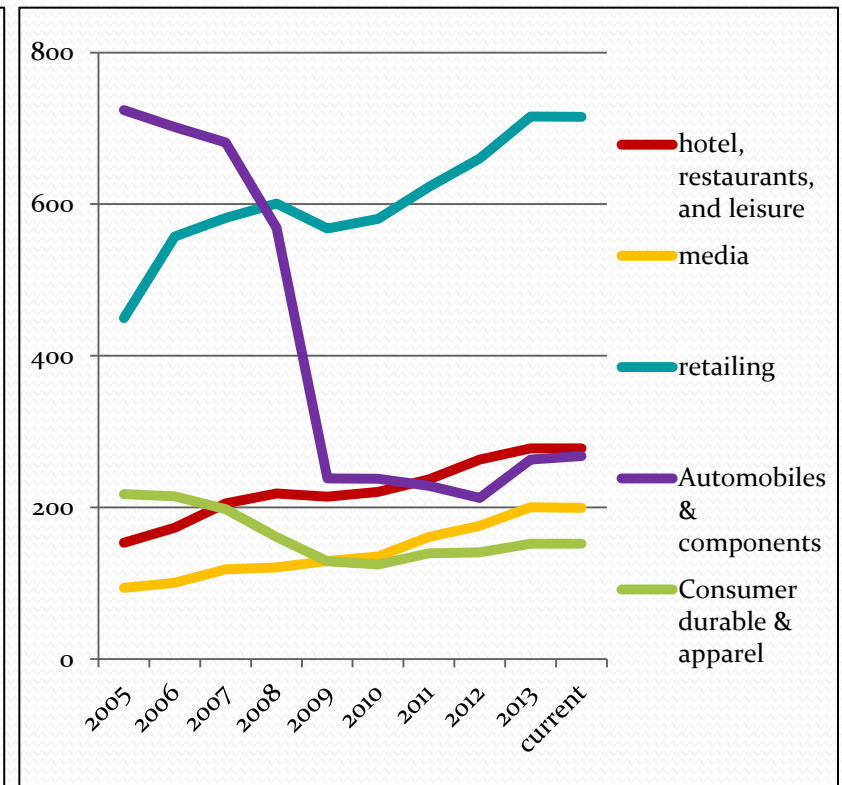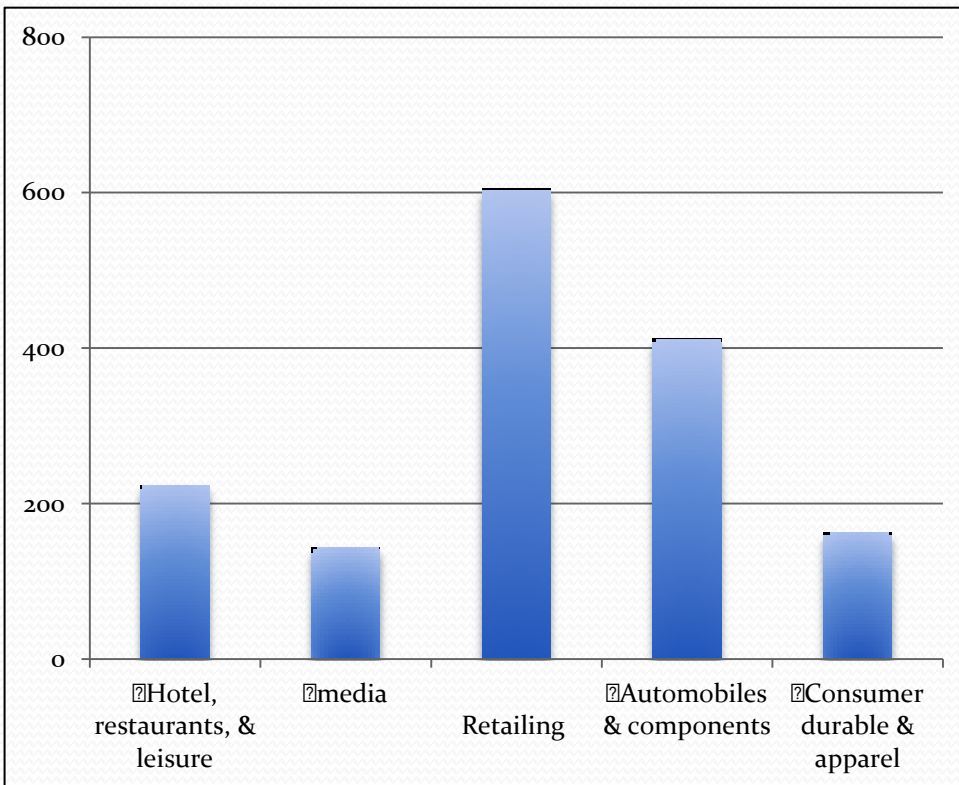
# Industry- Earnings per share

| Hotel, restaurants, & leisure | media | Retailing | Automobiles & components | Consumer durable & apparel |
|---|---|---|---|---|
| $25.96 | $13.87 | $28.05 | $1.68 | $10.48 |
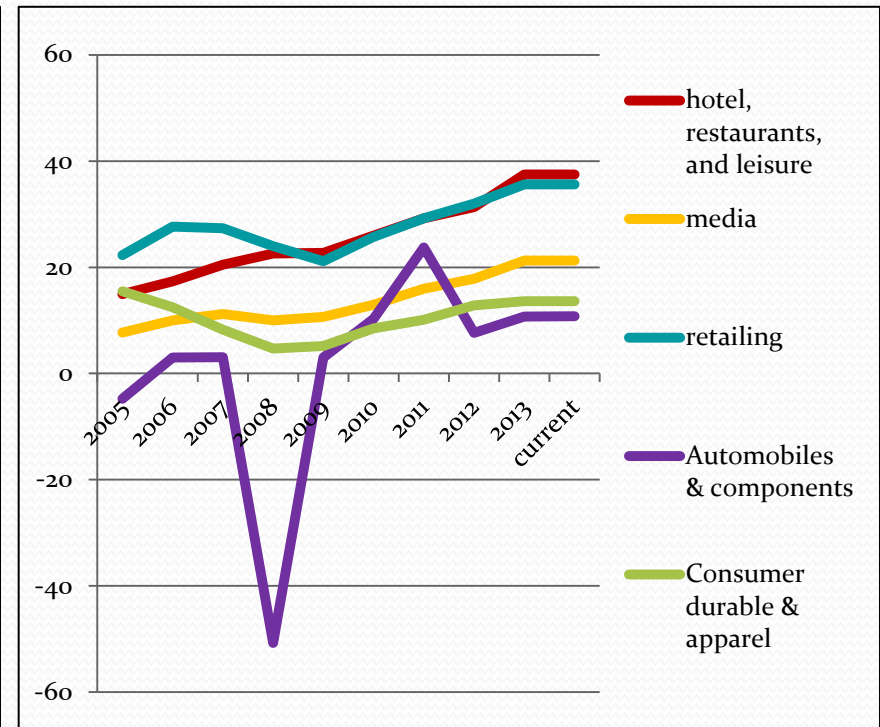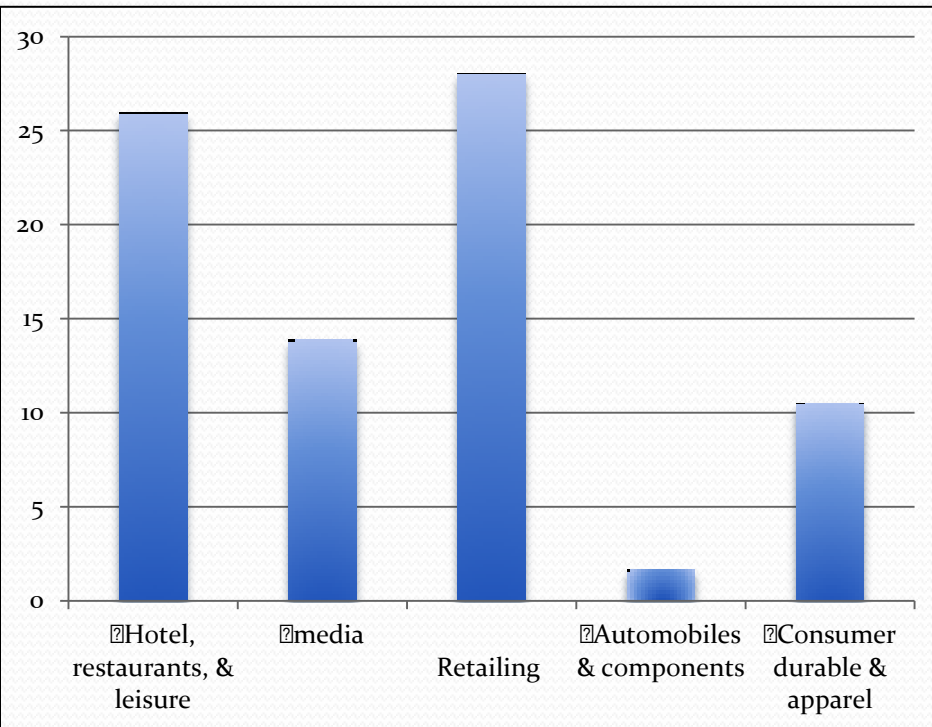
# Sector- Free cash flow

| 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | Current |
|------|------|------|------|------|------|------|------|------|---------|
| $5.14m | $6.62m | $15.43m | $5.27m | $8.35m | $19.4m | $20.45m | $20.84m | $23.12m | $23.22m |
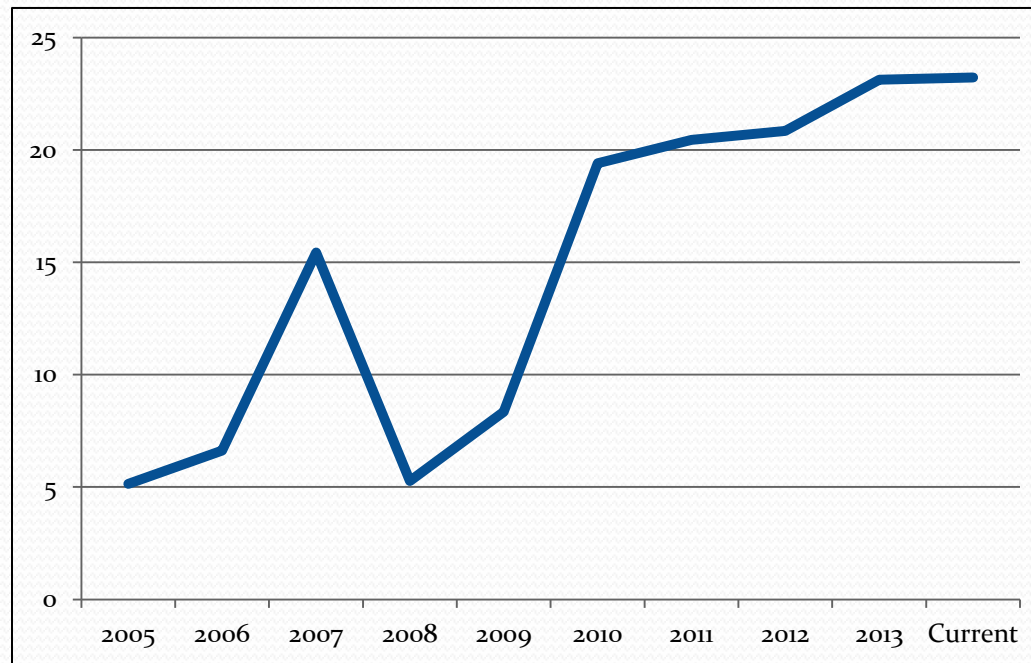
# Valuation Analysis

# Multiple Valuation (10 years)

| Absolute Basis | High | Low | Median | Current |
|---|---|---|---|---|
| P/E | 41.91 | 13.26 | 18.17 | 20.83 |
| P/S | 1.43 | 0.52 | 0.98 | 1.41 |
| P/B | 4.37 | 2.30 | 2.60 | 4.34 |
| P/CF | 14.62 | 8.16 | 10.31 | 12.90 |

| Relative to S&P500 | High | Low | Median | Current |
|---|---|---|---|---|
| P/E | 2.71 | 1.00 | 1.22 | 1.21 |
| P/S | 0.89 | 0.51 | 0.77 | 0.84 |
| P/B | 1.69 | 0.84 | 1.26 | 1.66 |
| P/CF | 1.44 | 0.52 | 1.27 | 1.43 |

# Sector relative to S&P 500

P/E
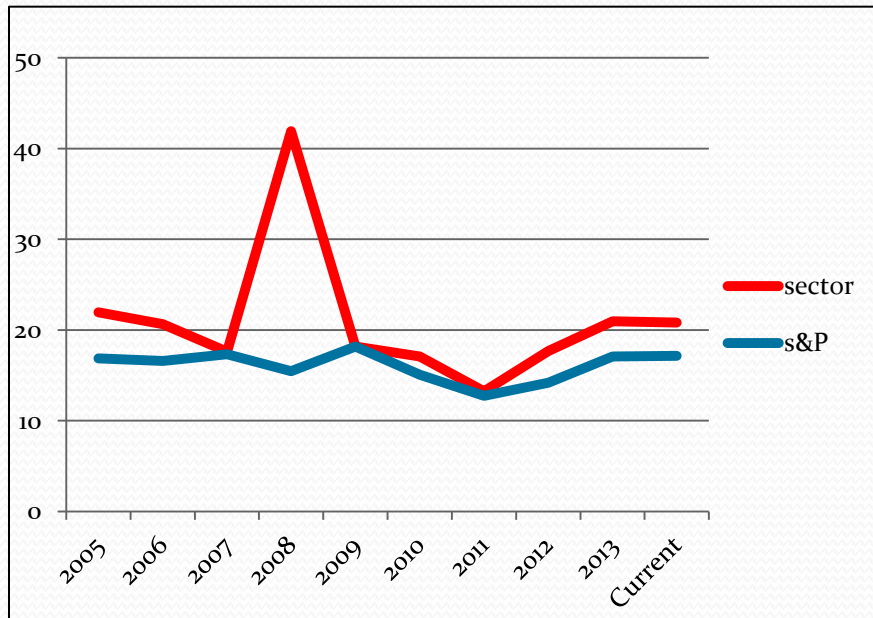


P/S
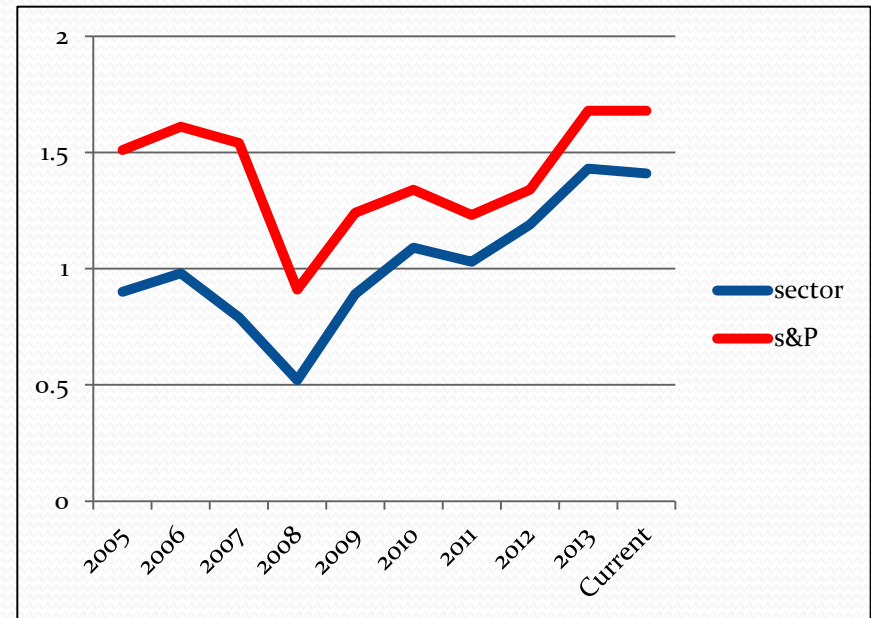
# Sector relative to S&P 500

P/B

P/CF
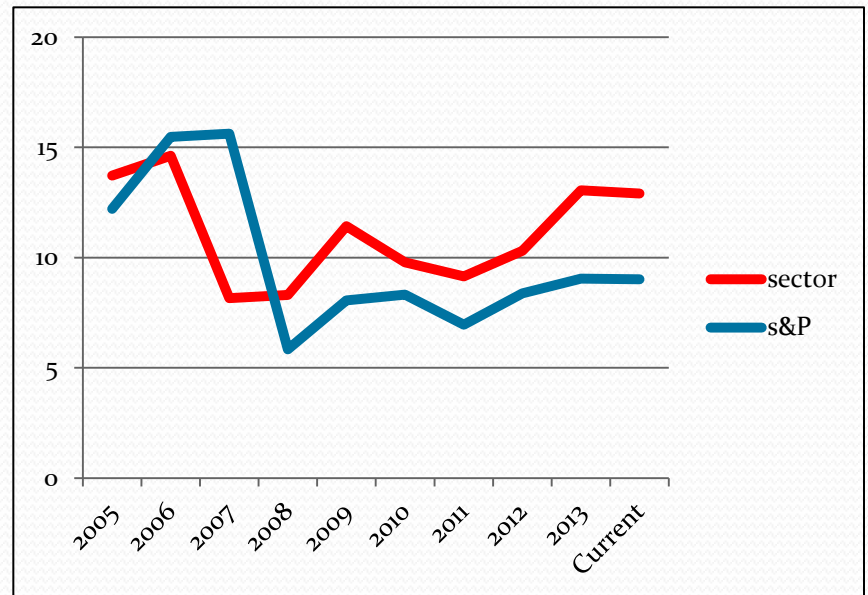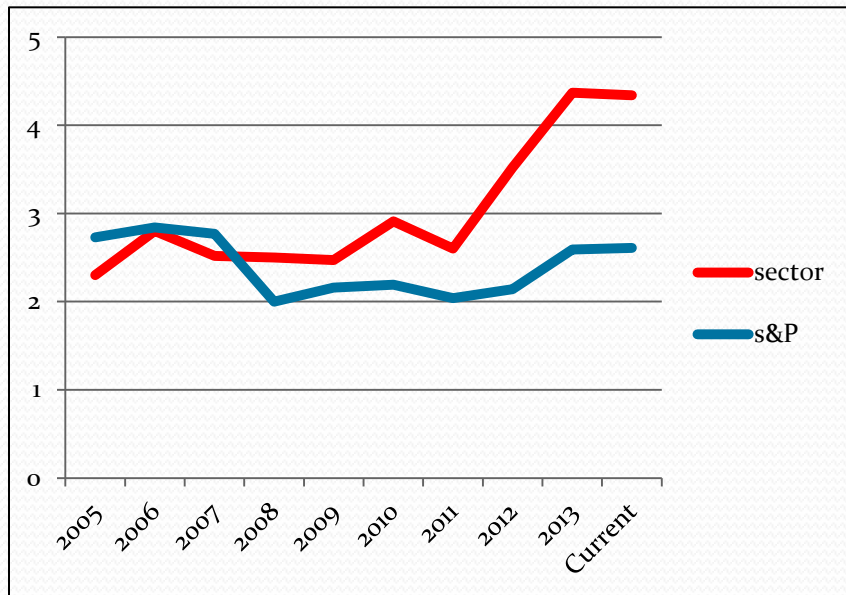
# Industry multiples

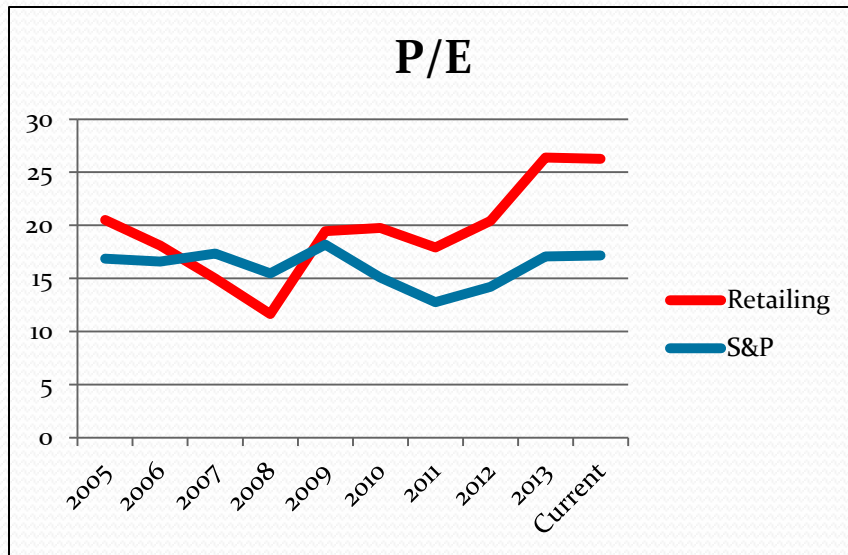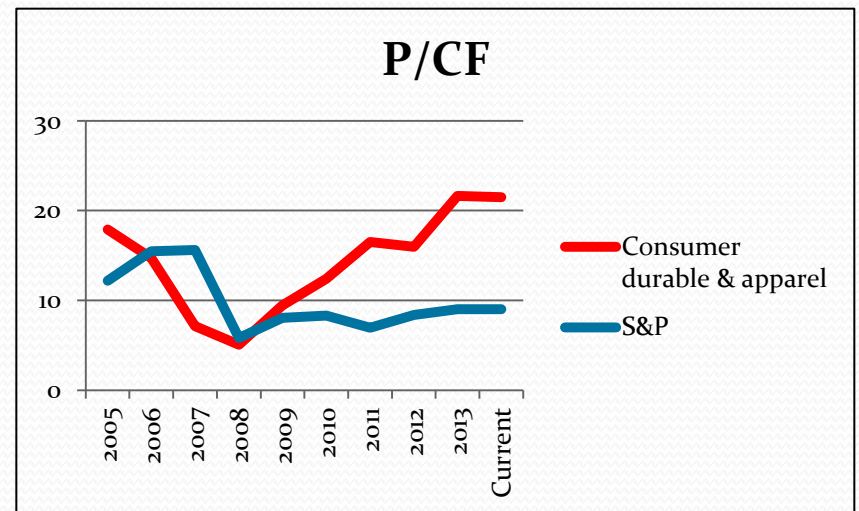| Industry | PE | PS | PB | PCF |
|---|---|---|---|---|
| Hotel, restaurants & leisure (relative to S&P) | 1.17 | 1.62 | 2.38 | 1.46 |
| Mc-Donald's(relative to sector) | 0.82 | 2.40 | 1.36 | 1.03 |
| Starbucks(relative to sector) | 0.73 | 2.47 | 2.52 | 1.28 |

# Hotel, restaurants & leisure (relative to S&P)
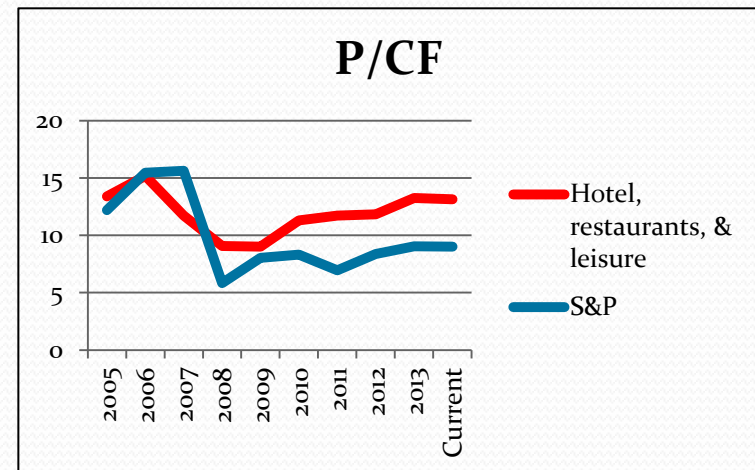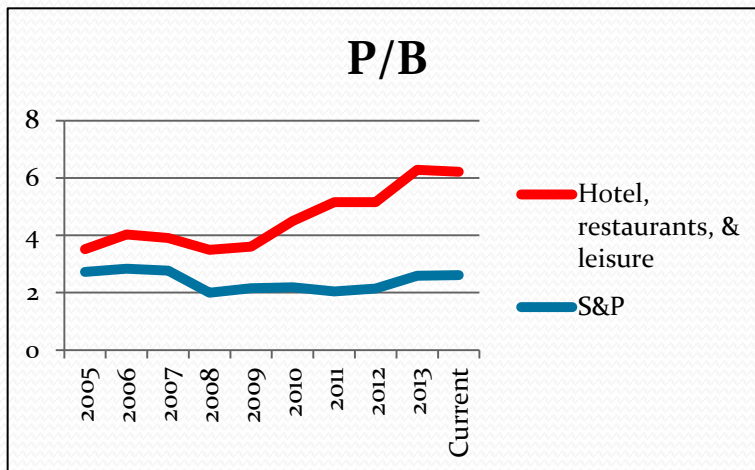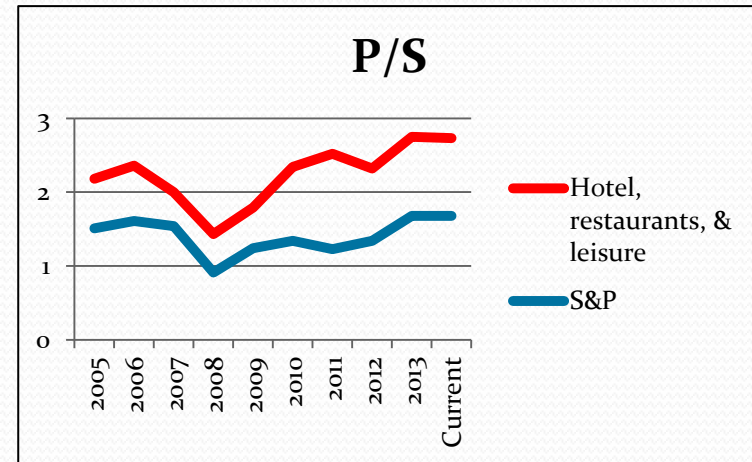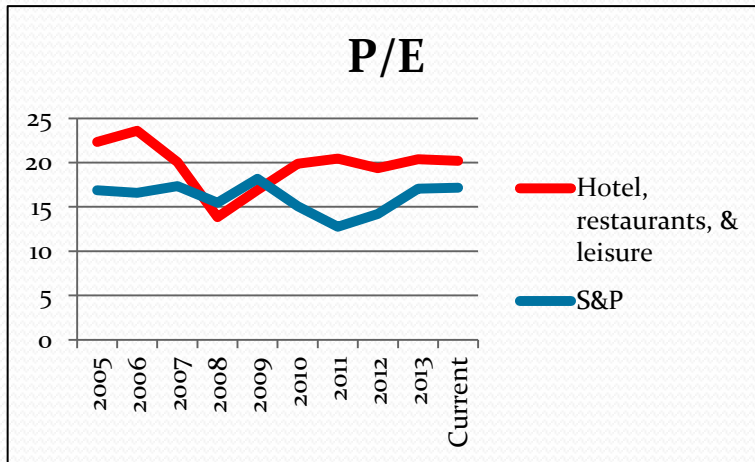
# Industry multiples

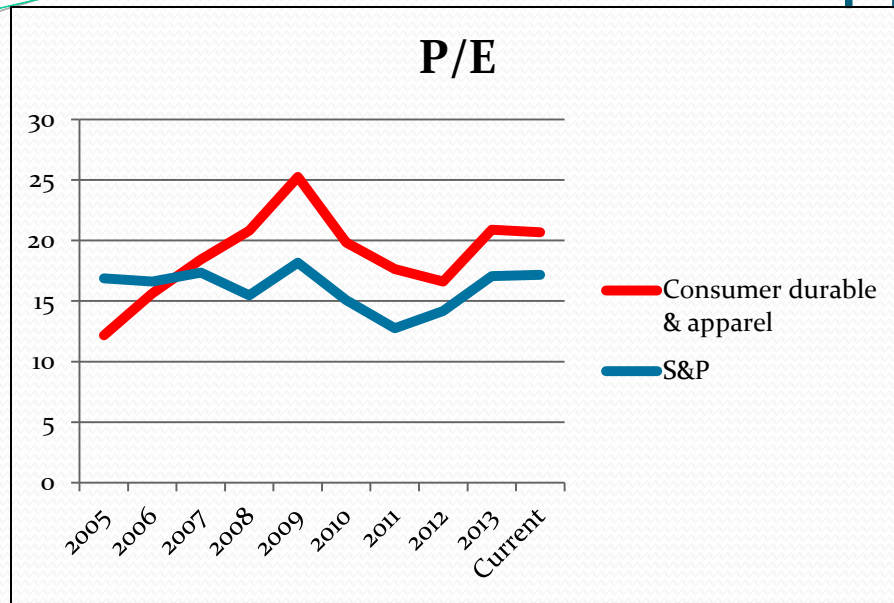| Industry | PE | PS | PB | PCF |
|---|---|---|---|---|
| Retailing(relative to S&P) | 1.53 | 0.78 | 2.45 | 1.73 |
| Amazon(relative to sector) | **30.77** | 1.57 | 3.93 | 2.35 |
| The Home Depot(relative to sector) | 1.05 | 1.05 | 2.12 | 1.17 |

# Retailing (relative to S&P)
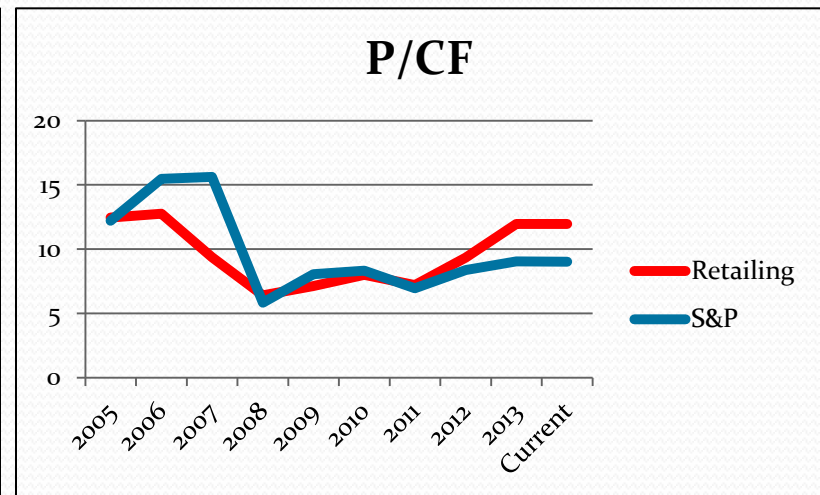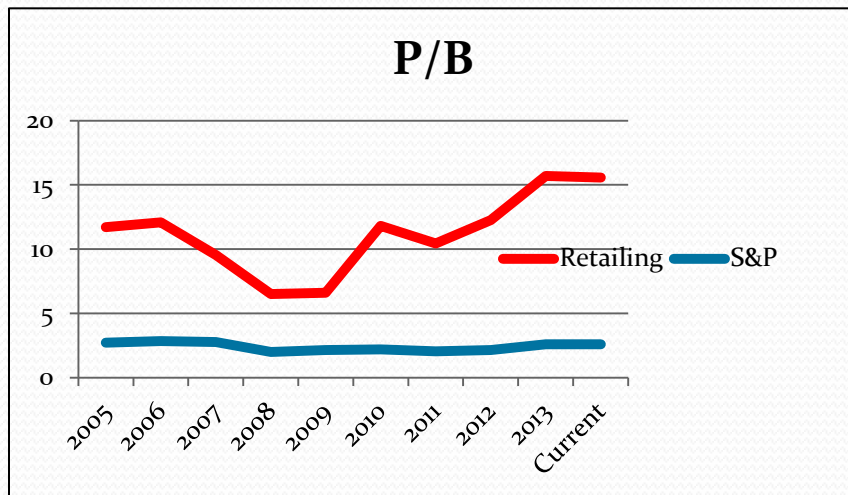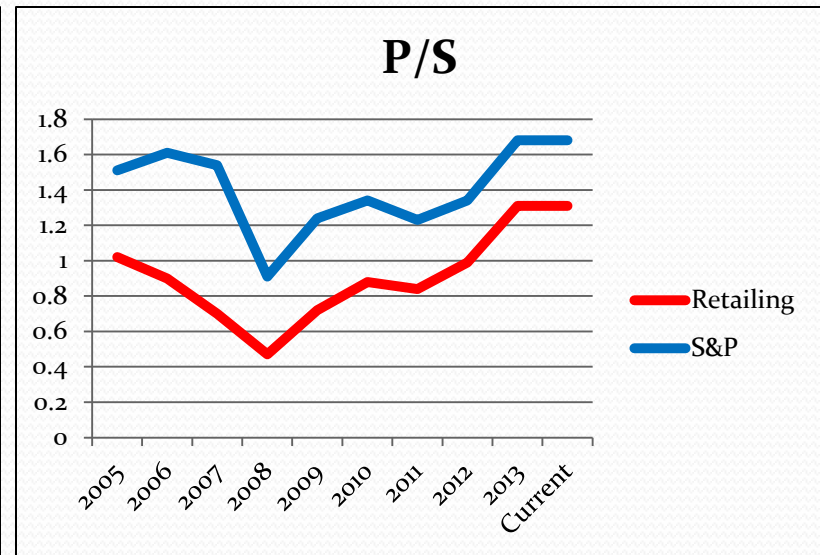
# Industry multiples

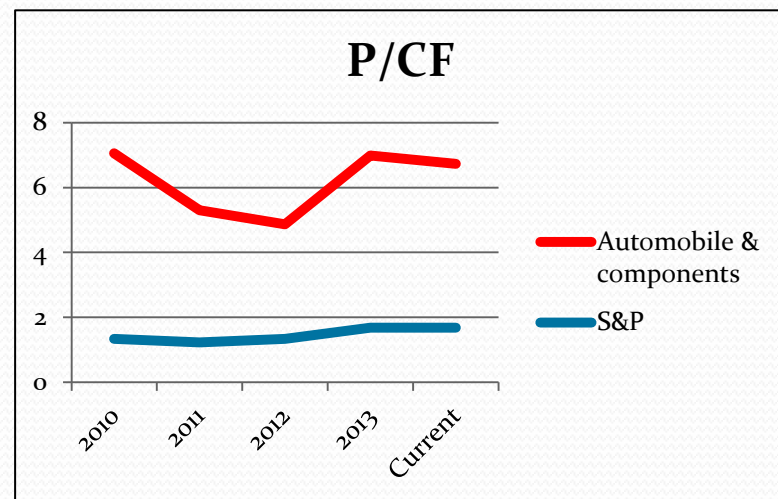| Industry | PE | PS | PB | PCF |
|---|---|---|---|---|
| Consumer durable& apparel(relative to S&P) | 1.20 | 1.10 | 1.47 | 2.38 |
| Nike(relative to sector) | 1.28 | 1.88 | 1.41 | 1.99 |
| VF(relative to sector) | 1.05 | 1.59 | 0.98 | 1.34 |

# Consumer durable& apparel(relative to S&P)
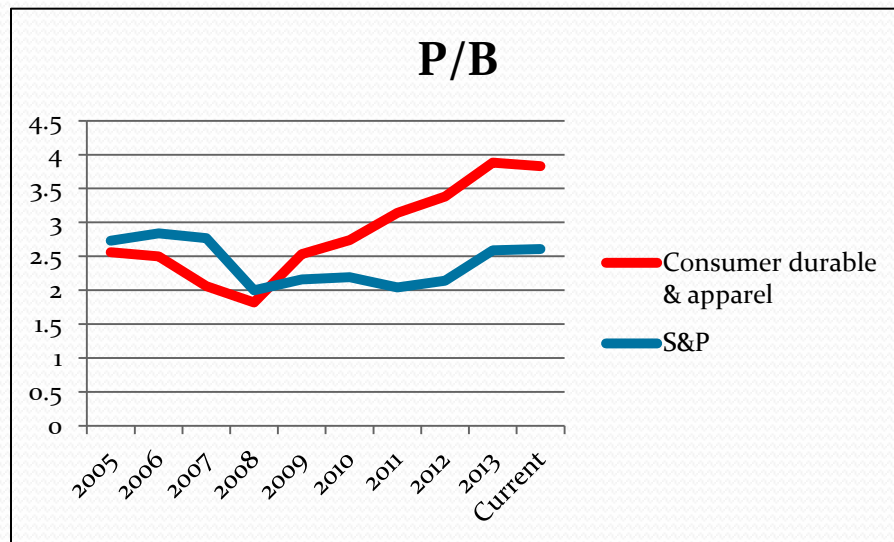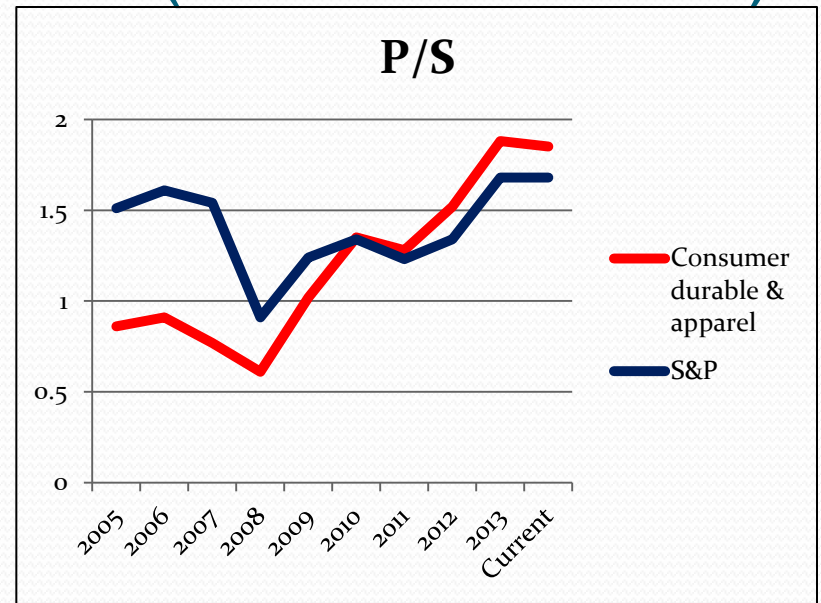
# Industry multiples

| Industry | PE | PS | PB | PCF |
|---|---|---|---|---|
| Automobile & components (relative to S&P) | 0.74 | 0.30 | 0.92 | 0.74 |
| Ford(relative to sector) | 0.41 | 0.29 | 0.52 | 0.39 |
| GM(relative to sector) | 0.73 | 0.27 | 0.32 | 0.31 |

# Automobile & components (relative to S&P)
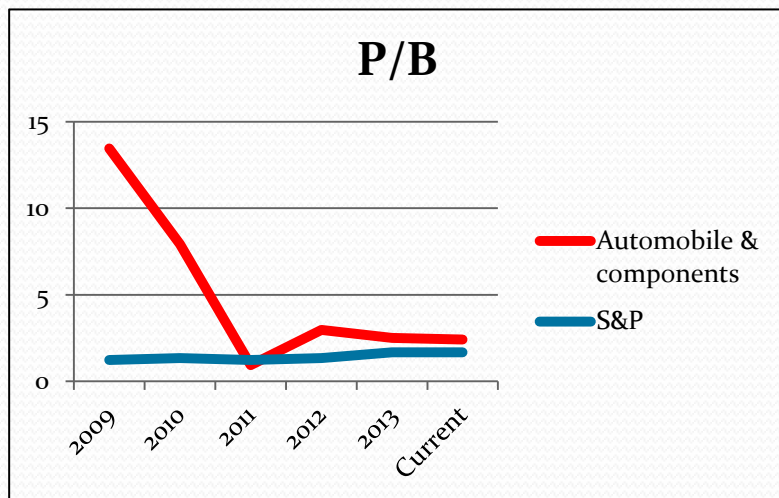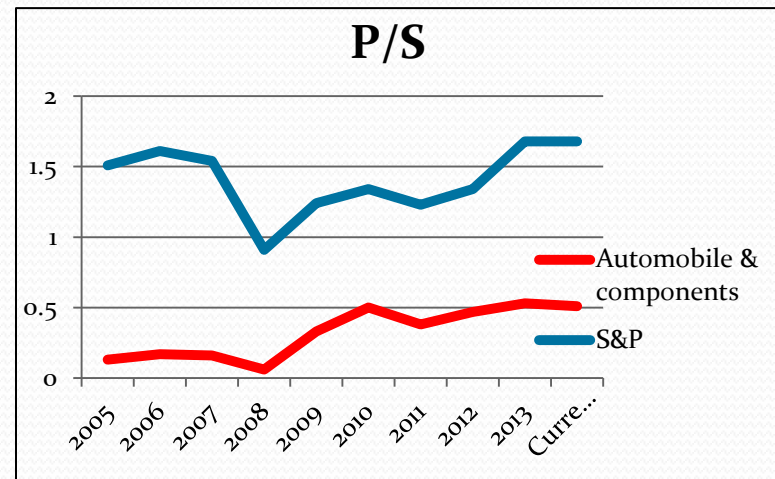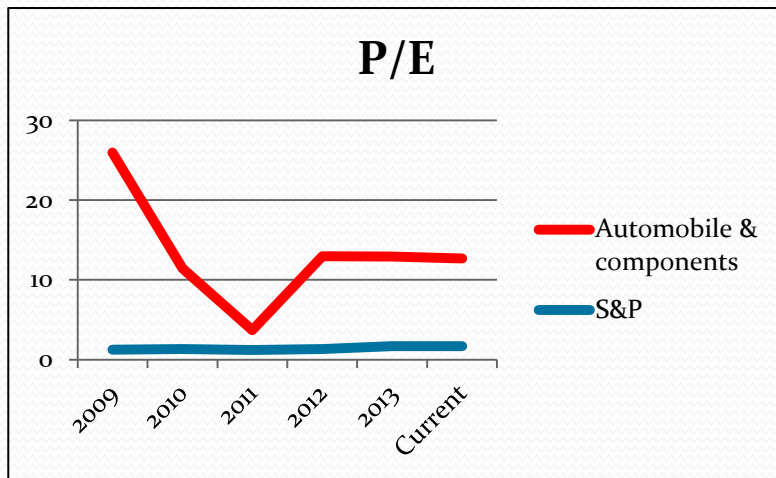
# Industry multiples

| Industry | PE | PS | PB | PCF |
|---|---|---|---|---|
| Media(relative to S&P) | 1.17 | 1.28 | 1.34 | 1.32 |
| Comcast(relative to sector) | 1.00 | 1.49 | 0.61 | 0.74 |
| CBS(relative to sector) | 1.06 | 1.89 | 0.92 | 1.68 |

# Media (relative to S&P)
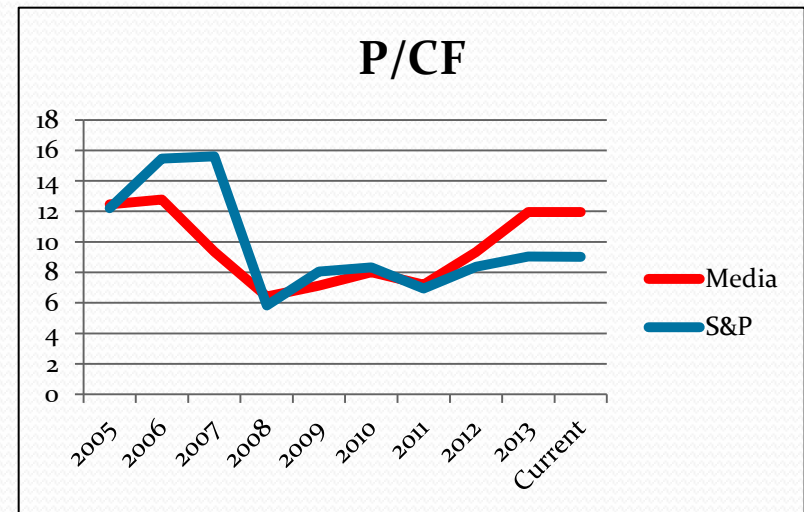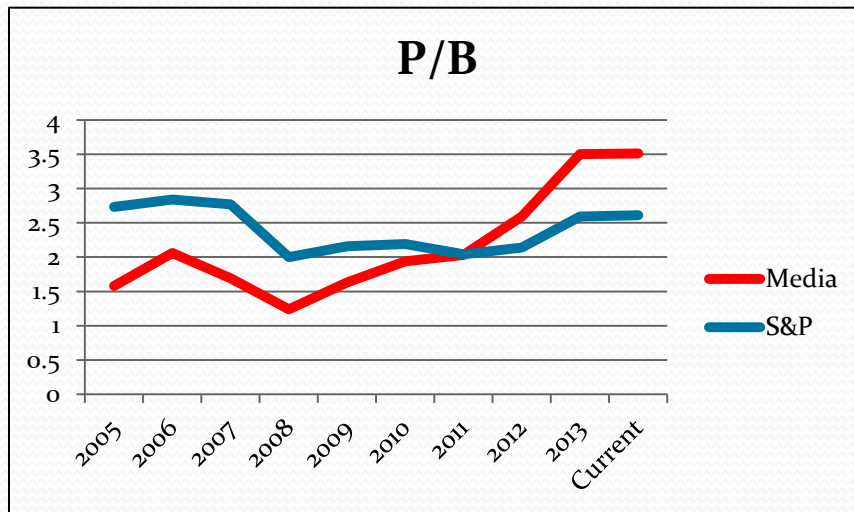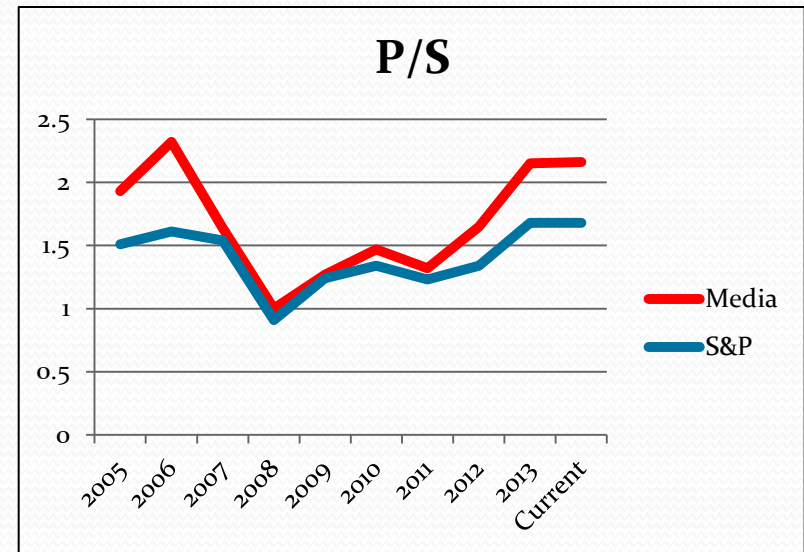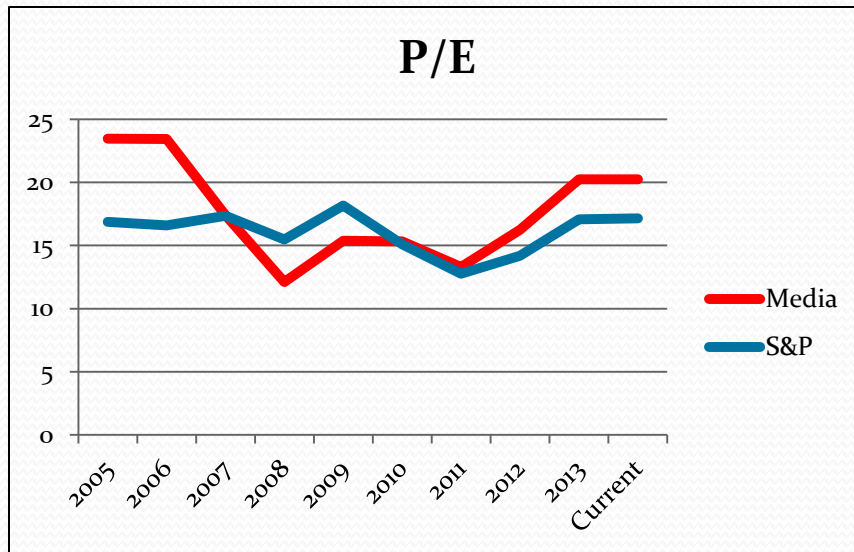
# Technical Analysis



$SRCD - S&P 500 Consumer Discretionary [Sector] - Weekly OHLC Chart

# Recommendations

# SIM should overweight

- From 1 year and 5 years perspective, con dis sector outperformed S&P 500
- YTD for con dis is lower than that for S&P 500, because of the bad weather
- However, MTD (February) is higher for con dis sector
- In 2014, we have many major positives for the U.S. economy

# Major Positives

- Economic stabilization and improvement in Europe
- U.S. housing market recovery
- Stock repurchase will make EPS higher in this sector



U.S. HOUSING STARTS



CONSUMER DISCRETIONARY EPS GROWTH
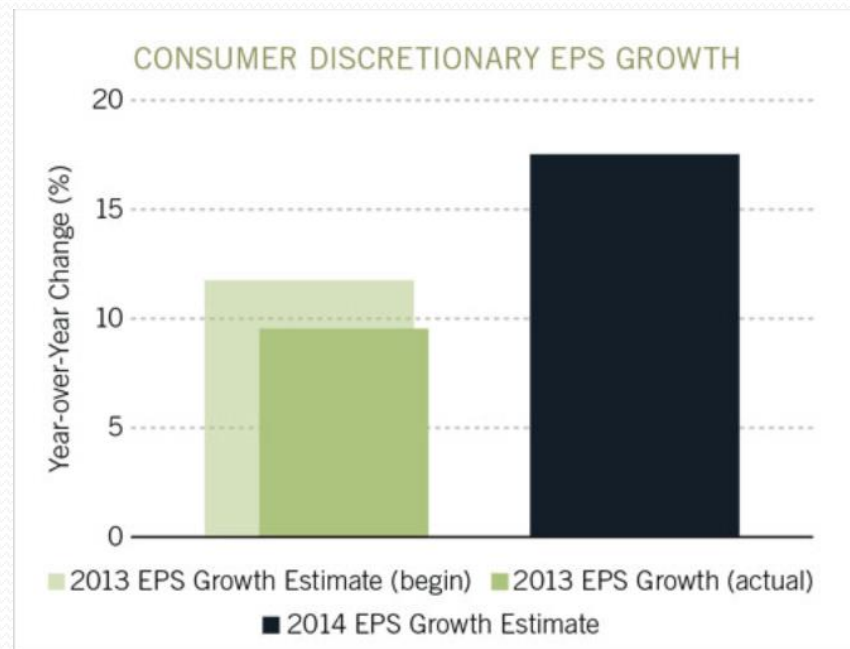
# Major Risks

- U.S. fiscal policy
  - Government shutdown in 2013 eroded the 4$^{th}$ quarter economy
  - The budget deal for fiscal year 2015 is a cause for concern in regards to consumer spending and confidence
- U.S. monetary policy
  - Fed's asset purchase program (Quantitative easing) will have a significant influence on interest rate and finally influence consumer discretionary sector, a sensitive sector.

# Overweight Hotel, restaurants & leisure

- The net profit margin for hotel industry is highest among industries

- Hotel's ROE and EPS is also higher than other industries

- Hotel's P/E, P/S, P/B and P/CF are all far higher than S&P 500

# Questions?